No. 3862.

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT

In the Matter of ELLIOTT-O'BRIEN COMPANY, a corporation, Bankrupt,

S. G. CLIMENSON, as Trustee of ELLIOTT-O'BRIEN COMPANY, a corporation, Bankrupt,

Appellant,

vs.

CARSON, PIRIE, SCOTT & COMPANY, a Corporation; COFFMAN, DOBSON BANK & TRUST COMPANY, a Corporation; BEE NUGGET PUBLISHING COMPANY, a corporation,

Appellees.

PETITION FOR RE-HEARING

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PETITION FOR RE-HEARING.

Comes now S. G. Climenson as Trustee of Elliott-O'Brien Company, a Corporation, bankrupt, Appellant, and petitions the Court for a re-hearing of said cause and as grounds therefore respectfully shows the Court:

I.

The opinion says:

"These objections were filed under subdivision g of Section 57 of the Bankruptcy Act, which provides as follows:

'g. The claims of creditors who have received preferences, voidable under section sixty, subdivision b, or to whom conveyances, transfers, assignments, or incumbrances, void or voidable under section sixty-seven, subdivision e, have been made or given, shall not be allowed unless such creditors shall surrender such preferences, conveyances, transfers, assignments, or incumbrances.'

"Subdivision b of Section 60 is the general provision relating to preferences under Bankruptcy Act. Subdivision e of Section 67 provides, among other things, as follows:

'And all conveyances, transfers, or incumbrances of his property made by a debtor at any time within four months prior to the filing of the petition against him, and while insolvent, which are held null and void as against the creditors of such debtor by the laws of the State, Territory, or District in which such property is situate, shall be deemed null and void under this Act against the creditors of such debtor if he be adjudged a bankrupt, and such property shall pass to the trustee and be by him reclaimed and recovered for the benefit of the creditors of the bankrupt.' "

The objections of the Trustee based on the ground of *preferences under the Bankruptcy Act* were necessarily filed under subdivision g of Section 57, above quoted.

But Appellant, as heretofore, contends that the objections of the Trustee, so far as said objections are *based on preferences under the State law,* were not filed under Sections 57g and 67e as stated in the opinion.

While the objections *might* be considered as filed under subdivision e of Section 67 and subdivision g of Section 57, the rights of the Trustee were not *limited* and *confined* to Section 67e. The fact is said objections were filed under subdivision e of Section 70 reading as follows:

"e. The trustee may avoid any transfer by the bankrupt of his property which any

creditor of such bankrupt might have avoided, and may recover the property so transferred, or its value, from the person to whom it was transferred, unless he was a bona fide holder for value prior to the date of the adjudication. Such property may be recovered or its value collected from whoever may have received it, except a bona fide holder for value. For the purpose of such recovery any court of bankruptcy as hereinbefore defined, and any State court which would have had jurisdiction if bankruptcy had not intervened, shall have concurrent jurisdiction."

The Trustee's reliance on Section 70e is expressly sustained by the Circuit Court of Appeals for the 2nd Circuit and by the United States Supreme Court:

Cordoso vs. Brooklyn Trust Co., 228 Fed. 333; 142 C. C. A. 625.

Stellwagen vs. Clum, 245 U. S. 605; 41 A. B. R. 1.

The *Cordoso* case involved a preference under the laws of New York wherein the transfer was made nine months before bankruptcy and hence could not come within Section 67e prescribing a four months limitation. The Court placed it under Section 70e.

The *Stellwagen* case involved a preference under the laws of Ohio. Mr. Justice Day said of Section 70e:

> "This section as construed by this court gives the Trustee in Bankruptcy a right of action to recover property transferred in violation of state law.
>
> "And a right of action in this subdivision is not subject to the four months' limitation or other sections (60 B, 67 E) of the Bankruptcy Act. In this subdivision, if a creditor could have avoided a transfer under state law, a Trustee may do the same."

Referring to Sec. 70e, 7 C. J. 182, says:

> "The effect of this provision is to give to the Trustee the same rights with respect to such transfers as are conferred on the bankrupt's creditors, or any of them, by the common law or the statutory law of the state where the property is located."

Collier on Bankruptcy (1921 ed.), page 1178, referring to Sec. 70e, says:

> "It is the corollary of Sec. 67b, and means simply that if a creditor could have avoided any transfer (not merely a lien) under the laws of the state, the Trustee can do the same,"

and cites *Williams vs. Davidson,* 104 Wash. 315, 176 Pac. 334.

The Supreme Court of the State of Washington has held that the right of a Trustee to recover pref-

erences under the State law is not subject to a four months' limitation, but has applied the rule to a transaction antedating bankruptcy by six months in one case and eleven months in another. Hence the case could not fall under Section 67e and did come within 70e.

Benner vs. Scandinavian American Bank, 73 Wash. 488; 131 Pac. 1149.

Jones vs. Hoquiam Lumber & Shingle Co., 98 Wash. 172; 167 Pac. 117.

The Trustee believes that the foregoing decisions establish *conclusively* that the right of the Trustee is not limited to the provisions of Sec. 67e, but that the Trustee may rely upon Sec. 70e of the Bankruptcy Act.

II.

The right of the Trustee to rely on Section 70e and to file objections to claims on the ground of preferences received contrary to the State law, is not found in subdivision g of Section 57 of the Bankruptcy Act as stated in the opinion.

The Trustee's objections were filed under the following Sections of the Bankruptcy Act:

Section 2:

"That the courts of bankruptcy * * * are hereby invested * * * (2) allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates."

Section 57d:

"Claims which have been duly proved shall be allowed, upon receipt by or upon presentation to the court, unless objection to their allowance shall be made by parties in interest, or their consideration be continued for cause by the court upon its own motion."

Section 57F:

"Objections to claims shall be heard and determined as soon as the convenience of the court and the best interest of the estates and the claimants will permit."

It is under the foregoing sections that objections to claims are commonly filed. Objections setting up such defenses as the bankrupt might have set up or *defenses that creditors of the bankrupt might have set up* are filed pursuant to the foregoing sections.

Collier on Bankruptcy, 10th ed. 812 *et seq.*

Remington on Bankruptcy, 2nd ed., pages 630-652.

Remington on Bankruptcy, 2nd ed., Sections 803, 803½, 11 92-1202.

Remington on Bankruptcy, 2nd ed., Sections 1137-1497.

In re. Rebman, 17 A. B. R. 767 (9 C. C. A.).

In re. Creech Bros. Lumber Co., 140 Fed. 8 (9 C. C. A.).

Moore vs. Crandall, 205 Fed. 689 (9 C. C. A.).

Wells vs. Lincoln, 214 Fed. 227 (9 C. C. A.).

Pacific States Bank vs. Coats, 205 Fed. 618 (9 C. C. A.).

In re Bement, 172 Fed. 98 (C. C. A. 8).

In re Omaha Motor Car Co., 245 Fed. 546 (C. C. A. 8).

In re Standard Telephone & Elec. Co., 216 U. S. 545, 24 A. B. R. 761.

The Trustee submits that under Section 2 (2), Section 57d, and Sec. 57f, that he may file objections to claims of creditors on any ground recognized by Sec. 70e of the Bankruptcy Act.

It is under these sections that Trustees have filed objections setting up such defenses as statute of limitations, statute of frauds, estoppel, illegality, usury, payment, fraud, etc.—in short, practically every defense known to the law. These things are matters of everyday practice in courts of bankruptcy.

Remington on Bankruptcy (2nd ed.), Sec. 1193-1202.

CONCLUSIONS.

Violation of state law gives rise to a cause of action in the Trustee under 70e.

Stellwagen vs. Clum, 245 U. S. 605.

The Trustee may object to any claim and set up any and all defenses that creditors possess under the law. Authorities above.

If this opinion is allowed to stand there will be one rule in the Federal Court and another in the State Court. Great confusion will result. Some will depend on the one rule and some on the other. We know of no case sustaining the opinion and, as we have pointed out, it is at variance and inreconcilable with the Washington cases above cited, and with the decision of the Supreme Court of the United States.

IV.

Finally, if Appellant should be in error in all we have said; if it be conceded for the sake of argu-

ment that Judge Rudkin is right in holding that the Trustee's objections were filed under Sec. 57g and 67e, still, the opinion is erroneous in holding that the trustee must prove insolvency in both the bankruptcy sense (excess of liabilities over assets) and in the State sense defined as non-payment of debts as they mature in the ordinary course of business; for the Trust Fund Theory prohibits a private corporation from preferring creditors in *either* kind of insolvency.

I. A corporation insolvent (1) in that its liabilities exceed assets and which (2) is unable to meet its obligations in due course of business, cannot prefer its creditors. Everyone would admit this.

II. A corporation whose liabilities do not *exceed* its assets but is unable to pay its obligations as they mature in due course of busines, cannot prefer its creditors (insolvent in so-called state sense only).

Simpson vs. Western Hardware & Metal Co., 97 Wash. 626, 167 Pac. 113.

III. A corporation insolvent only in the sense that its liabilities exceed its assets cannot prefer its creditors (insolvent in bankruptcy sense only).

Benner vs. Scandinavian American Bank, 73 Wash. 488, 131 Pac. 1149.

Under the opinion in this case, a trustee in bankruptcy must prove a transfer (1) within four months of bankruptcy, (2) insolvency in the bankruptcy sense, namely, excess of liabilities over assets, (3) insolvency in state sense as defined by opinion, namely, non-payment of debts as they mature in the ordinary course of business, (4) preference.

This is contrary to the law as laid down by the Supreme Court of the U. S. and by the Supreme Court of the State of Washington:

A.

Under the decisions of the United States Supreme Court, a trustee need not prove insolvency in the bankruptcy sense, but may prove insolvency under state law and (2) preference.

Stellwagen vs. Clum, 245 U. S. 605.

Under the decisions of the Circuit Court of Appeals for the 2nd Circuit the trustees need prove only (1) insolvency in the State sense and (2) preference.

Grandison vs. Robertson, 231 Fed. 785.

Cordoso vs. Brooklyn Trust Co., 228 Fed. 33.

B.

Under the decisions of the Supreme Court of the State of Washington, insolvency in the bankruptcy sense need not be proved; *proof in the so-called State sense alone* is sufficient.

Simpson vs. Western Hardware & Metal Co., 97 Wash. 626, 167 Pac. 113.

Insolvency in the so-called State sense need not be proven; *proof in the bankruptcy sense only* need be proved.

Benner vs. Scandinavian-American Bank, 73 Wash. 488.

Nor is a trustee required to prove the transfer within four months.

Benner vs. Scandinavian American Bank, 73 Wash. 488, 131 Pac. 1149.

Jones vs. Hoquiam Lumber & Shingle Co., 98 Wash. 172, 167 Pac. 117.

The rule is the same in New York.

Cordoso vs. Brooklyn Trust Co., 228 Fed. 333.

The rule laid down in the opinion is at variance with the rule of the State Court in two particulars: the Federal rule requires proof of insolvency in both the bankruptcy sense and in the State sense and, second, the transfer must be within four months. The State Courts hold proof of insolvency in *either* sense is sufficient and, second, there is no four months limitation.

BASIS OF TRUST FUND THEORY.

All the Washington decisions are rested chiefly on Section 741 (5) Rem. Comp. Sts. (1922) reading as follows:

> "A receiver may be appointed by the Court in the following cases: (5) When a corporation has been dissolved or is insolvent, or is in imminent danger of insolvency, or has forfeited its corporate rights."

If there is imminent danger of insolvency a receiver will be appointed.

State ex rel. Strohl vs. Superior Court, 20 Wash. 545.

Kahle vs. Ind. Loan & Inv. Co., 103 Wash. 273, 174 Pac. 23.

The object and purpose of the theory is to secure an equal and ratable distribution of assets among the creditors, to prevent discrimination and preferences.

Thompson vs. Huron Lumber Co., 4 Wash. 600, 30 Pac. 741, 31 Pac. 25.

Conover vs. Hull, 10 Wash. 673, 39 Pac. 166.

A corporation whose liabilities exceed assets is more certain to prefer than one merely unable to pay in due course. The reason for the rule prohibiting preferences is more apparent and more imperative.

It appeared in evidence that the state court appointed a receiver on the ground of insolvency on May 7, 1921 (Trustee's Exhibit "G", R. 154). There was no material change in the condition of this corporation in the month's period preceding. If it was insolvent on May 7th, it was surely in *imminent* danger of insolvency during the month of April, certainly five days before, and had the court given effect to the statute above quoted, it would have held payments made to appellees during April, 1921, were made during the time when the now bankrupt was in imminent danger of insolvency.

The error of the opinion lies in holding that the

definition of insolvency, namely: "inability to pay debts as they mature in the ordinary course of business" is an *exclusive* definition. There is no decision and no statement in any of the decisions of the state court that a corporation is not insolvent when it appears that its liabilities are in excess of assets. There is one late decision holding that a corporation whose liabilities exceed its assets is insolvent and that a preference under such conditions will be set aside.

Benner vs. Scandinavian-American Bank, 73 Wash. 488, 131 Pac. 1149.

The Washington court holds that it is not necessary to prove absolute insolvency, meaning excess of liabilities over assets, but that it is sufficient to show that the corporation is not paying its obligations as they mature in the ordinary course of business. Such is the plain reasoning of the cases cited in the opinion:

Nixon vs. Hendy Machine Works, 51 Wash. 419;

State ex rel. Strohl vs. Superior Court, 25 Wash. 545;

Jones vs. Hoquiam Lumber & Shingle Co., 98 Wash. 172.

Had this court followed the latest decision of the Supreme Court of the State of Washington in *Davidson vs. Williams,* 104 Wash. 315, where the court found liabilities exceeded assets and "during all of this time the corporation was heavily indebted, the greater portion of its indebtedness being past due, and it was unable to pay, and apparently was in a failing condition," judgment would have been rendered in favor of the trustee.

Had the court followed the decision in *Cunningham vs. Norbon,* 125 U. S., 77, 31 L. ed. 624, where the court said:

> "When a person is unable to pay his debts he is understood to be insolvent. It is difficult to give a more accurate definition of insolvency",

judgment would have been for the trustee.

In this case the trustee in bankruptcy testified that the concern during 1921 was unable to pay its obligations as they matured in due course of business (Record 99). Mr. Elliott, president and manager of the bankrupt, testified the concern was unable to pay its debts in due course of business, as the books will show (Record 60, 152):

THE BANKRUPT'S LEDGER SHOWS

	Merchandise past due	Merchandise not due	Bank	Total
January	$3,970.68	$7,108.15	$5,500.00	$16,578.83
February	3,436.14	9,291.39	5,500.00	18,227.53
March	4,788.78	9,527.45	5,500.00	19,816.24
April	8,693.19	3,823.42	5,500.00	18,116.61

—(Trustee's Ex. "B" at R. 152.)

The correspondence states that they were fearful lest some creditor whose account is past due will step in and ask for the appointment of a receiver.

There was no testimony that the concern was paying its bills in due course of business. There was no testimony that creditors were satisfied with the handling of the bankrupt's accounts, except some testimony that the Western Dry Goods Company, one of the creditors, was satisfied with receipt of payment of $500.00 and a promise to pay the balance within the next two months. It is manifest that the creditors of this estate had no knowledge of any kind of the payments made to appellees.

Instead of being satisfied with what was taking place these creditors, had they known the facts, would not have extended any credit to the bankrupt concern. No wholesaler in the country would knowingly have sold a concern whose financial condition

was that of the bankrupt. None would have been satisfied with the appellees taking 80% of the money representing sales of the bankrupt during the last thirty-five days and receive nothing themselves. Such a statement carries its own refutation.

Brevity requires an end, and we believe consideration of the foregoing petition will show the error of the court.

Respectfully submitted,

NELSON R. ANDERSON,

Attorney for Appellants.